1812

1953

Monthly Letter on Economic Conditions Government Finance

New York, March, 1953

General Business Conditions

THE business indexes have held at high levels during February. In overall terms, industrial production is the highest ever reached in peacetime, and according to some measures exceeds the war peak. Most of the heavy industries are working at or close to capacity against well-filled order books, for defense and otherwise. The optimistic expectations of the automobile manufacturers and makers of other consumers' durable goods are reflected in high production schedules. Steel mill operations hold at the peak. As would be expected under such conditions, employment and personal incomes hold at postwar highs, and the soft goods industries also are busy, although they are not under as much pressure. January retail sales, while a little below December after seasonal adjustment, were 10 per cent above a year ago. February also will show gains.

Predictions made toward the end of the last year of sustained activity in the construction and capital goods industries find support in the January figures. Contract awards, expenditures for new construction and new housing starts during the month were all well above a year ago, and higher, allowing for seasonal factors, than the 1952 average rate. Some of the machinery and equipment manufacturers would like to have more orders, but in the aggregate new business is still large, activity for months ahead is assured, and with some exceptions a good year is expected.

The Inventory Question

As a whole, trade and industrial reports make it clear that business is moving with good momentum. In fact, doubts as to the 1953 outlook center on the premise that momentum may be too strong to last, and sales expectations too optimistic; if so, production through the spring months may be overdone. At present levels of output some increase in stocks seems to be occurring. During the fourth quarter of 1952 business inventories rose by half a billion dollars. While this is moderate, and the total at the end of the period was little above a year earlier, stocks usually decline during the fourth quarter. Any indication that output may be exceeding consumption naturally raises a question as to how long the present record production rates can be supported.

For the early future, however, these speculations have little significance. Among automobile manufacturers, home builders and others looking forward to good spring markets, the disposition is to move confidently, prepare for good business, put forth a strong selling effort, and maintain high production schedules. They will be ready to cut back if and when sales and inventory figures indicate the need, but see no purpose in crossing the bridge until it is reached, and hope it will not be. They are relying upon distributors to do a good job. One effect is that competition will be intense.

Staple commodity prices, whose downward trend has been of concern as possibly indicating

CONTENTS

basic weakness, declined further in the early part of the month, but have since firmed appreciably. February is frequently a seasonally low month in many agricultural prices. Some of the most important of these are now at or below support levels; and on the whole the disposition is to take a more confident view of farm price prospects, at least for the months just ahead.

Removal of Controls

The action of President Eisenhower on February 6, suspending wage controls entirely and speeding the removal of remaining price controls, has been received everywhere with satisfaction. The markets themselves have been demonstrating for a long time that the conditions which led to the establishment of price controls more than two years ago no longer exist. In one line after another prices have dropped below ceilings, making the controls in such cases inoperative. The burden and expense of the reports and record-keeping, however, have continued. Relief in that respect is one of the benefits of the President's action.

The response of the markets has been much as was expected by those who have opposed the extension of controls. When the question was up last June, Mr. Putnam, then Economic Stabilization Administrator, and Mr. Arnall, the Price Stabilizer, uttered dire predictions as to the price increases to be expected if controls were ended — predictions repeated this time by the present Stabilizer, Mr. Freehill. Actually there were no signs, then or recently, that anything of the sort was likely or that decontrol would be very eventful. The ceiling removals of the past month have had little effect on prices. Both scrap and refined copper have been marked up; higher scrap prices were needed to bring out a greater supply, and refined copper was far below the world price. A few consumers' goods have risen above the former ceilings, a sign that larger supplies are wanted and the best way to bring them forth. But most prices are unaffected.

In retrospect, it seems questionable whether price controls, except in specific cases such as copper, had much influence on price trends for more than a brief period. They were put into effect at a time when the influences pushing prices upward, which — as it turned out — were largely forward buying and inventory accumulation, probably had almost exhausted themselves. By the spring of 1951 many business men had built up inventories and forward commitments as far as they believed desirable, and consumers likewise had stocked up. Market pressures therefore abated. To be sure, it may be argued that the ceilings themselves repressed forward demand, because they removed fears of further advances; but among the complex market influences it would be hard to appraise precisely the effect of any one.

Controls Based on Faulty Assumptions

What is clear is that the assumptions advanced two years ago as justification for establishing general price controls were never fully valid. The reduction in supplies of civilian goods caused by diversion of resources to defense needs has been much less than was then expected. Defense expenditures did not rise as rapidly or as much as forecast. Moreover, the productive organization turned in a truly stupendous accomplishment in pouring goods into the markets. Calculations of the Department of Commerce, as given in the "Survey of Current Business" for February, show that while Federal Government purchases of goods and services (measured in constant dollars to represent physical quantities) nearly doubled from 1949 to 1952, the rise in production nevertheless permitted increases of nearly 7 per cent in personal consumption, 14 per cent in new construction and 19 per cent in output of producers' durable equipment, to say nothing of the inventory increase which took place over the period.

In February 1951, few believed such an achievement was possible. Soon after price controls were imposed, however, uncertainties as to supplies of general merchandise, including durable goods, began to disappear. By the spring and summer of 1951 it was also found that the buying splurges of July 1950 and the early weeks of 1951 were exceptions in consumer behavior, and not the rule. Normal saving habits soon reasserted themselves.

The final important contribution to the control of inflationary influences was the substantial freeing of monetary policy from the restrictions imposed upon the Federal Reserve authorities by Treasury policy. Supplemented and strengthened, as long as was deemed necessary, by direct restrictions upon the expansion of consumer and real estate credit, and by the voluntary credit restraint program adopted by the country's banks and other lending institutions, Federal Reserve policy again assumed its function of limiting credit expansion under inflationary conditions. A restrictive money policy deals with the upward pressures on prices at their source.

The Return to Free Markets

For all these reasons price controls, except in a few specific areas, gradually became inoper-

ative. They have plainly outlasted their usefulness and lost their purpose. In a broader sense, however, this is not the most gratifying reason for their removal. The greater cause for satisfaction is the reassertion of the principle that free markets represent the normal and desirable way of life for the American economy. Business has had to operate under price controls for more than eight years out of the past thirteen, and the country should be under no illusions about them. They are costly and disruptive and for the most part are tolerable only when they are ineffective.

From the time price ceilings are established adjustments become necessary, because costs change and demand shift. In free markets these adjustments occur freely and almost automatically. In markets controlled by government officials they are, at the best, subject to cumbersome procedures and delays, and, at the worst, they may never be made. When price changes are inhibited or hampered, the performance of their economic function, which is to guide and balance production and consumption and to direct economic effort and resource use, is also inhibited or hampered. The effect is to reduce the efficiency of the producing and distributing organization. In contrast, the free market system permits determination by the consumer of the amounts, types and qualities of products he wants at prices he is willing to pay.

The Money Market

The Administration's moves to decontrol prices, and also the Federal Reserve Board's action effective February 20 reducing minimum stock margin requirements from 75 per cent to 50 per cent, fit into a broad program of dropping emergency devices invoked since the Korean war began. Under the program now unfolding the restraints on inflation rest, where they basically must belong, in fiscal and credit policies — balancing the federal budget through expenditure reduction and keeping a curb on credit and money supply through the Federal Reserve's discount rate and open market operations. The increase from 1¾ to 2 per cent in the discount rate, effective January 16, was in a real sense a precursor to the decontrol moves. It is clear that the authorities will be ready to adjust the rate again if greater restraint is needed.

The January discount rate action did not interfere with a highly successful outcome on the first major piece of financing undertaken by the new Administration, the refunding of the $8,868 million certificates of indebtedness which fell due February 15. The holders of these certificates were offered in exchange their choice between a one-year certificate paying 2¼ per cent, and a five-year ten-months bond paying 2½ per cent. Secretary of the Treasury George M. Humphrey revealed on February 13 that exchange subscriptions totaling $8,114 million had been received for the new 2¼ per cent certificates plus $620 million for the new 2½ per cent bonds. The aggregate subscriptions for the new certificates and bonds, $8,734 million, left only $134 million or 1½ per cent of the maturing certificates to be paid off in cash. This is the best result the Treasury has had on a major refunding since 1944.

Treasury officials had further reason for gratification in the fact that, unlike most Treasury refundings over the past twelve years, the operation was carried through without the Federal Reserve Banks' posting bids in the open market to insure a satisfactory result. On the other hand, while the Treasury had expected the one-year certificates to attract the main demand, some disappointment was expressed that subscriptions to the 2½ per cent bonds did not reach a billion or better. It was the 2¼ per cent rate on the one-year certificates that carried the exchange. The impression in the market is that the Treasury will have to offer rates in the zone of 2¾ to 3¼ per cent to achieve substantial results in extending public debt maturities.

President Eisenhower in his State of the Union message February 2 clearly implied that the February financing was simply a first trial step in a "program of extending part of the debt over longer periods and gradually placing greater amounts in the hands of longer-term investors". In consonance with this policy, it is to be expected that the Treasury will be willing to pay the rates required to attract a broad demand in a free market. There is no thought of having the Federal Reserve Banks put out money to accommodate the Treasury on some prearranged interest rate schedule.

Money Market Developments

Despite the seasonal return flow of currency and easing in credit demands from business, the money market has remained fairly tight and bond prices in recent weeks have weakened. An $845 million reduction in Federal Reserve holdings of government securities since December 31, plus $524 million foreign withdrawals of gold, have had the effect of maintaining bank borrowings from the Federal Reserve around a level of $1 billion, thus giving banks more of a taste of the 2 per cent discount rate than many of them might have anticipated at the time the rate was raised. While credit demands from business have decreased seasonally, demand for credit to finance consumers continues to expand.

Moreover, as March 15 approaches there is a tendency to anticipate an acceleration of business loan demands to help finance the record $6½ billion tax payments falling due at that time. Treasury bill yields during February held close to the 2 per cent discount rate level and at the month-end edged up toward 2⅛ per cent.

Bond Yields Strengthen

In the area of long-term credits, 1953 demands of the mortgage market are looming larger than had been anticipated some months ago and the flow of corporate, State and municipal bond issues has been heavy. As another market factor, some investors are tending to reserve buying power for the long-term U. S. Government bond issue expected to be offered later on in the year. Sharp advances in offered yields were required to move State and municipal bonds. Yields on U. S. Government and high-grade corporate bonds also rose.

On new corporate flotations, the previously existing demand for high-grade obligations in the range of 3 to 3¼ per cent dried up. A $40 million issue of thirty-year Consolidated Edison of New York bonds required a return of 3⅜ per cent to put the issue across. Last March a $50 million issue of Consolidated Edison thirty-year bonds was placed at 3¼ per cent. As evidence of a longer drift of rates, Consolidated Edison sold $200 million thirty and thirty-five year refunding bonds early in 1947 at about 2⅝ per cent. That was near the crest of the bull market for bonds based on wartime inflation of the money supply.

Confidence in Money

These interest rate changes, by historical standards, are modest. They serve the economic function of bringing credit supply and demand toward balance. What has spared the economy need for larger adjustments is the responsiveness of the flow of funds to rate changes. Another force has been the falling off in inflation psychology and a renewal of faith in the outlook for the value of the dollar. The leveling of the cost of living index, and declines in industrial raw material and food prices, have been helpful in firming confidence in the value of savings accounts and bond investments. The drive to balance the federal budget, the plan to improve the structure of the debt, and the reactivation of discount rate as an instrument toward economic stability, all add up to a better prospect for the dollar.

Some such considerations as these seem to be at work, jointly with the improvement in terms and renewed sales efforts, enlarging the market for U.S. Savings bonds. In the first two months of 1953 sales of Savings bonds are estimated to have reached $900 million, one-sixth better than in January-February last year and the best performance over the Korean war period. Redemptions, which have tended to run in excess of sales over this period, amounted to about $820 million in January and February, 9 per cent below last year's figure and lowest for the first two months of any year since 1948.

The Tax Outlook

During the past month the American people have been subjected to a barrage of apparently conflicting statements and opinion over tax policy.

On the one hand, the House Ways and Means Committee, headed by Representative Daniel A. Reed of New York, has reported out a bill (H.R. 1) which would advance the automatic termination date of temporary personal income tax increases voted in the Revenue Act of 1951 from December 31, 1953, as presently scheduled, to June 30, 1953 – the latter coinciding with the presently scheduled expiration date of the corporate excess profits tax, which the committee strongly maintains should be allowed to become effective. The committee takes the position that "tax reduction must be a first order of business for this Congress." It declares that H. R. 1 should be pushed through without delay, holding that "tax reduction now will be a strong inducement for the elimination of unnecessary expenditures."

The position of the Administration, on the other hand, as indicated in statements by President Eisenhower and supported by House and Senate leaders, is that, while tax reduction is urgently needed and desired, final decisions on tax policy should be postponed until a clearer view can be had of the budgetary outlook. The President's view, as stated in his press interview of February 17, is that taxes ought not to be cut until a balanced budget is "in sight".

The effect of these and other pronouncements emanating in a stream from both Congressional and Administration sources, and more particularly of the varying interpretations placed upon them, has been confusing and has perhaps created the appearance of a greater cleavage as to fundamental objectives than actually exists. What seems to be occurring is the building up of an impression of two alternatives – one of going ahead with tax cuts regardless of what happens to the budget, and the other of extending present tax rates until some indefinite future time when a balanced budget can be shown to be an accomplished fact.

This is unfortunate and needless. At this stage no one can possibly have any very precise idea

how the budget is coming out, hence no basis exists as yet for formulating a firm opinion.

Tax Cuts and Budget Cuts Interdependent

Actually, there is little doubt but that the Administration and the Congress share the common purpose to do two things: cut both expenditures and taxes. Despite the tendency in much of the current discussion to put expenditure reduction and tax reduction in separate compartments, in reality they are mutually interdependent. Certainly no sound basis exists for tax reduction unless expenditures are drastically reduced. On the other hand, much of the necessary incentive to carry through on expenditure reductions will be lost unless such reductions are going to be reflected in tax cuts pretty promptly.

The ideal procedure is to have the two move along together. Some individuals may feel it necessary to keep the pressure on reducing expenditures by not letting tax reduction go ahead too fast. Others may feel that by demanding tax reduction they are bringing pressure for reduction in expenditures. Apart, however, from the disadvantages noted above of treating the two problems independently, there is the risk of getting people lined up in opposing camps when essentially they are working for the same end. The danger is in each side getting "frozen in" with fixed ideas and preconceptions while the situation is still fluid. The Administration and the Congress have a big job to do to cut expenditures, but there is still time — and a necessity — for keeping an open mind until we can see better how we are coming out in the overall picture.

A Practical Procedure

Happily, despite all the talk of Congressional "revolt" against the Administration over taxes, neither side is taking a wholly inflexible attitude. Chairman Reed of the House Ways and Means Committee is understood to have indicated a willingness not to press for immediate consideration of his bill, but to hold off and give opportunity for appraising progress in cutting expenditures. The Administration, on its part, certainly has not turned down tax reduction, but is opposed to action until visibility as to outgo becomes a little plainer. Secretary of the Treasury Humphrey recently stated that he does not expect to formulate a tax program for two or three months. The President, as noted above, has indicated that he will be satisfied if a balanced budget is a reasonable prospect.

If, in the period between now and May or June the appropriations committees of the Congress, the Budget Bureau, and the different departments can agree upon budgetary cuts, that figure can be made effective by an expenditures limitation such as was passed by the House last year in the Smith-Coudert amendment to the defense appropriations bill and is now included in different form in the bill proposed by Senator Byrd and 45 other Senators. If that total is somewhere in the range of the revised revenue estimates that will be available, in the ordinary way, in April — we shall have a practical fulfillment of the Administration requirement that a balanced budget is "in sight." Then the scheduled tax reduction can get the "green light" to go ahead.

The Minimum Objective

Meantime, the thing to do is to concentrate on the task of reducing expenditures. Here the minimum objective must be to accomplish savings sufficient to permit expiration of the corporate excess profits tax on June 30 next and of the temporary personal income tax increases on December 31, as now provided by law, and still leave a balanced budget.

This means scaling some $10 billion from the Truman budget of $78.6 billion presented last January, if the calculation is on the basis of the official accounting of receipts and expenditures, or some $6½ billion if the calculation is on the basis of consolidated cash receipts and expenditures, including social security taxes. To go further and advance the date of expiration of the temporary personal income tax increases to June 30, 1953, as contemplated in the Reed bill and as is regarded in Congress generally as a political "must" if the corporate excess profits tax is allowed to expire on that date, would mean, according to Treasury estimates, an additional revenue loss of $1.5 billion.

Whether it will prove practicable to accomplish the needed reductions in expenditures in time, while still meeting the all-important mandate of no impairment of essential defense strength, remains of course to be seen. But there should be no defeatism at this point. The efforts being made on the Executive side and in the Congress are genuine and promise good results. Much depends also upon the reliability of the Truman budget estimates. As may be recalled, the tendency of recent budgets has been to grossly overestimate expenditures.

Question of the Excess Profits Tax

On the revenue side, doubts as to reliability of budget estimates apply particularly to the excess profits tax. This is due partly to the decline in corporate income before taxes which, as reported in the article on 1952 corporate earnings

in this Letter, caused many concerns to drop out of the excess profits tax bracket. It is due partly also to growing suspicion that the amount of revenue lost through reductions in net income – either because of extra expense to avoid E.P.T., or because of ventures which are not engaged in because of E.P.T. – may substantially offset the direct revenue realized from E.P.T.

Moreover, if this tax, with its innumerable problems, is not permitted to terminate on June 30, 1953, many organizations that have been urging the Congress to grant relief where the tax is bearing down inequitably will probably succeed in getting some legislation through the present session of Congress which will further reduce the present yield, and possibly even offset it entirely.

On the other hand, if the tax is permitted to terminate, many present wasteful practices now being availed of as deductions will no doubt be eliminated, thus increasing the total of corporate profits subject to normal and surtax.

Aside from revenue considerations, if this tax is extended the Congressional tax-writing committees might well be bogged down for months in dealing with applications for relief instead of getting ahead on their long-range program of tax reform for which they have already collected a mass of information now awaiting analysis.

All this is on account of a tax which has been thoroughly discredited and which almost everyone agrees should be allowed to expire in a comparatively short time anyway.

Corporate Earnings in 1952

Some two thousand annual reports of corporations for the year 1952 now available show that earnings declined as compared with 1951 for a majority of the reporting companies engaged in manufacturing, mining, and trade. There were increases generally in the fields of transportation, public utilities, and finance. For all reporting corporations together the net income declined slightly as compared with 1951, which in turn was slightly below 1950. The continued high level of business activity resulted in a new all-time record in dollar transactions, but the persistent rise in operating expenses, combined with special factors such as strikes, inventory write-downs, and O.P.S. ceilings, caused some narrowing of the average net profit margin per sales or revenue dollar in almost all lines.

Our tabulation of the reports issued to date by 2,237 corporations in all major lines shows combined net income of approximately $8.1 billion after taxes, compared with $8.4 billion in 1951, a decrease of 3 per cent. Slightly over half of the individual companies reported decreases. The condensed table gives a preliminary summary of the changes by major industry groups.

Preliminary Summary of Net Income of Leading Corporations for the Years 1951 and 1952

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1951	1952	Per Cent Change
14	Baking	$ 36,227	$ 37,920	+ 5
18	Meat packing	46,374	32,232	—30
18	Sugar	51,367	34,730	—32
63	Other food products	194,775	170,491	—12
43	Beverages	136,112	92,592	—32
15	Tobacco products	75,611	68,627	— 9
29	Cotton goods	63,690	31,004	—51
48	Other textile products	104,064	36,425	—65
21	Clothing and apparel	12,953	10,910	—16
23	Shoes, leather, etc.	24,540	21,488	—12
16	Tires, rubber products	172,784	159,408	— 8
21	Lumber, wood products	36,321	22,882	—37
41	Paper and allied prod.	204,128	170,759	—16
48	Chemical products	599,127	565,796	— 6
22	Drugs, soap, cosmetics	147,850	121,898	—18
13	Paint and varnish	29,476	25,518	—13
43	Petroleum prod. & ref.	1,260,456	1,235,620	— 2
15	Cement	34,505	38,752	+12
8	Glass products	75,558	78,418	+ 4
24	Other stone, clay prod.	87,784	76,949	—12
39	Iron and steel	663,436	515,066	—22
11	Agricultural imple.	139,123	133,791	— 4
37	Bldg., heat., plumb. eq.	52,683	41,211	—22
40	Elec. equip., radio & tv.	173,939	180,610	+ 4
31	Hardware and tools	31,974	26,529	—17
17	Household appliances	28,509	28,214	— 1
98	Machinery	129,777	133,010	+ 2
14	Office equipment	67,231	64,668	— 4
68	Other metal products	226,047	183,462	—19
9	Autos and trucks	92,780	96,852	+ 4
42	Automobile parts	116,738	102,697	—12
23	Aircraft and parts	48,674	61,994	+27
59	Misc. manufacturing	62,797	61,230	— 2
1,031	Total manufacturing	5,227,360	4,661,753	—11
15	Coal mining*	36,823	25,428	—31
6	Metal mining*	10,375	8,963	—14
5	Other mining, quarry.	12,743	13,148	+ 3
26	Total mining, quarry.*	59,941	47,539	—21
15	Chain stores—food	51,096	48,441	— 5
36	Chain st.—variety, etc.	110,986	101,631	— 8
41	Department & specialty	100,229	91,336	— 9
37	Wholesale and misc.	68,332	46,028	—33
129	Total trade	330,643	287,436	—13
131	Class 1 railroads	690,568	826,874	+20
11	Air transport	30,942	31,845	+ 3
45	Misc. transportation	24,633	30,735	+25
187	Total transportation	746,143	889,454	+19
144	Elec. power, gas, etc.	682,845	781,440	+14
44	Telephone & telegraph	393,968	435,557	+11
188	Total public utilities	1,076,813	1,216,997	+13
13	Amusements	24,867	18,571	—25
22	Restaurant and hotel	1,149	1,658	+44
17	Other business services	38,548	33,967	—12
10	Construction	6,433	8,114	+26
62	Total amuse., serv., etc.	70,997	62,310	—12
313	Commercial banks	510,470	550,683	+ 8
18	Fire and casualty ins.†	32,040	44,118	+38
168	Investment trusts†	229,825	244,709	+ 6
57	Sales finance companies	101,116	108,255	+ 7
58	Real estate companies	8,822	14,557	+65
614	Total finance	882,273	962,322	+ 9
2,237	Grand total	$8,394,170	$8,127,811	— 3

* Net income is reported before depletion charges in some cases.
† Figures in most cases exclude capital gains or losses on investments.

In the manufacturing industries the statements of 1,031 companies show combined net income down 11 per cent. Almost three out of every four

companies had decreases. Textile products and several other lines were hard hit early in the year by a slackened demand on the part of buyers anxious to work down inventory.

The steel strike of eight weeks last summer curtailed substantially the year's output of steel and of countless products made of steel, despite the vigorous rebound that took place in the fourth quarter. For a group of 39 iron and steel producers a decrease of 10 per cent in the dollar total of sales resulted in a decline in operating earnings of approximately $980 million, or 51 per cent. Of this loss in taxable income, $830 million, or almost seven-eighths, was offset by a reduction in federal income and excess profits taxes payable. The net income after taxes declined by $150 million, or 22 per cent.

Earnings of Food Processors

Among the 113 food manufacturing or processing companies that have reported to date, two out of three had decreases in net income, and the combined total was down 16 per cent. Most companies in these lines experienced narrower profit margins, as labor costs continued to rise while selling prices were held down by government ceilings or by the forces of competition.

It is noteworthy that this showing is in contrast with the charge by the Executive Council of the American Federation of Labor at its midwinter meeting at Miami Beach last month, as reported in the New York Times, that

> food processors and distributors were increasing their profits at the expense of both farmers and urban workers.
>
> "Between the third quarter of 1951 and the third quarter of 1952, when farm income was already lagging behind the rest of the economy, corporations processing and marketing food were rapidly increasing their profits," the A.F.L. declared. "During this period, the Federal Trade Commission reports that net corporate income, after taxes, of firms in the food group rose from $204,000,000 to $255,000,000, an increase of 25 per cent."

This statement by the A. F. of L. is open to criticism on two counts. First, it fails to use the latest revised figures given in the report cited for the third quarter of 1952. According to this report, issued jointly by the Federal Trade Commission and the Securities & Exchange Commission, the net income of the food group in the third quarter of 1951 was estimated at $220 million, not $204 million. Thus the increase over a year ago was 16 per cent, not 25 per cent as charged.

Secondly, and more important, the A. F. of L. omitted the comparisons given in the same report covering the first nine months of 1952, which showed estimated net income for the food group of $622 million, compared with $674 million in the corresponding period of 1951, a decrease of 8 per cent. The average annual rate of return computed on shareholders' equity in the first three quarters declined from 8.6 to 7.7 per cent, while the average net profit margin declined from 2.1 to 1.9 cents per dollar of sales.

Other Earnings Factors

Other manufacturing lines in which representative companies maintained sales but experienced varying squeezes of profit margin include beverages, tobacco products, shoes and leather, tires, paper, chemicals, and petroleum refining. Our preliminary summary shows only a few groups which were able, with the help of sizable gains in dollar sales, to increase net income.

The rise of operating costs generally reflected the continued advance of wages, which as measured by average hourly earnings in manufacturing rose from $1.636 in December 1951 to $1.732 in December 1952 or by 6 per cent—exclusive of fringe benefits. Important offsets in many instances were increases in productivity resulting from improved plant and equipment, and decreases in the costs of foodstuffs or industrial raw materials purchased.

Tax details given by the larger companies in all manufacturing lines reporting to date indicate that operating income, before taxes, decreased last year by about 23 per cent. This left but little income subject to the 82 per cent excess profits tax bracket, and resulted in a 31 per cent decrease in the total federal tax liability on 1952 income, payable in 1953. Federal tax accruals, including the normal tax, surtax, and excess profits tax, declined from an average of 60 per cent of income in 1951 to 54 per cent in 1952.

Among the 129 retail and wholesale trade companies reporting thus far there was a general squeezing of profit margins, with net income down in three out of four individual cases and down 13 per cent for the group as a whole.

Most of the public utility systems supplying electric, gas, and telephone services had a continued advance last year in both operating revenues and net income. Their relatively good showing reflected the steady growth in demand for their services, control over costs, some increases in rates charged, and increased productivity reflecting the huge investment made since the war in additional plant and equipment.

Reports for many additional corporations that become available during the current month will be included in our final summary in the April issue. This will show also, by major industry groups, the average rates of return on net assets and profit margins on sales.

Balance Sheet Changes

A comparison of the December 31, 1952 balance sheets of 150 manufacturing companies shows that expansion in total assets continued last year at a slower pace, and that the rise of inventories, which had absorbed funds heavily in every postwar year except 1949, was checked. The general trends among the major items are indicated by the following composite balance sheet, based upon a limited sample of industry and more representative of the larger organizations than of small business.

Composite Balance Sheet of 150 Manufacturing Companies with Sales or Total Assets over $5 Million

(In Millions of Dollars)

Assets	1940	1945	1951	1952
Cash	$ 522	$ 802	$1,045	$1,088
Government securities†	46	766	1,322	1,212
Receivables, net	531	969	1,719	1,927
Inventories*	1,202	1,855	4,053	4,157
Total current assets	2,301	4,392	8,139	8,384
Land, plant and equipment	3,528	4,078	7,318	8,075
Less depreciation	1,688	2,484	3,471	3,757
Net property	1,840	1,594	3,847	4,318
Other assets	503	423	681	763
Total assets	4,644	6,409	12,667	13,465
Liabilities and Capital				
Notes payable	73	223	390	353
A/c pay., accruals, etc.*	320	613	1,207	1,424
Reserve for taxes†	223	754	1,616	1,340
Total current liab.	616	1,590	3,213	3,117
Bonds, notes, etc.	555	474	1,811	2,321
Reserves	89	173	207	223
Capital and Surplus	3,384	4,172	7,436	7,804
Total	4,644	6,409	12,667	13,465
Working capital	1,685	2,802	4.926	5,267
Ratios:				
Cur. assets to cur. liab.	3.74	2.76	2.53	2.69
Cash & govts. to curr. liab.	0.92	0.99	0.74	0.74
Equity cap. to total liab.	2.89	2.02	1.43	1.44

† Before deducting tax notes offset against taxes payable.
* Includes advances on government contracts.

These companies had sales last year of approximately $19 billion. Their total assets at the year-end aggregated $13.5 billion, an increase during the year of $798 million. Of that increase, about one-third took place in the current assets, mostly in receivables. While some of the statements showed further accumulation of inventories last year, others showed sizable reductions, leaving the total for the group up only slightly.

Most of the other asset expansion occurred in net property account, where the increase practically duplicated the record increase in 1951. Gross outlay on plant and equipment exceeded the increase in net property to the extent of the $286 million written off for depreciation.

More than half of the total funds absorbed was provided by an increase in long-term liabilities, including long-term bank loans, insurance loans, and open market bonds.

The rest of the funds used came from an increase in capital and surplus, mainly from the retention of net income — only about 60 per cent of which was paid out in dividends.

The ratio of current assets to current liabilities at the year-end rose slightly to 2.69, compared with 3.74 in prewar 1940. The ratio of cash plus government securities alone to total current liabilities stood at the end of last year at 0.74, compared with 0.92 in 1940. Net working capital in dollars, however, representing the excess of current assets over current liabilities, continued to increase last year to a figure three times prewar.

Accompanying the decline that has taken place in these liquidity ratios, there was a decline also in the relation of equity capital (including surplus) to total liabilities (short- and long-term). For the 150 companies in our composite statement this ratio declined from 2.89 in 1940 to 1.44 in 1952.

These indications of decreased liquidity emphasize the problem that business has had to face in raising the huge amounts of new capital to pay for the expansion in plant and equipment, plus the added working capital, needed to meet the tremendous military and civilian demands for goods. The postwar inflation of wages and prices has added greatly to the cost of replacing and enlarging industrial plant and equipment, as well as to the volume of funds required to carry enlarged inventories and receivables. Although outlays this year for new plant and equipment will still be large, the longer-term demands for corporate funds should lessen with the stabilizing tendency of both business activity and commodity prices. This should slow down the necessary borrowing, and eventually restore a higher ratio of equity money to debt. It should also permit paying out a larger share of earnings as dividends — especially in those cases where corporations are trying to attract new capital by the sale of additional stock.

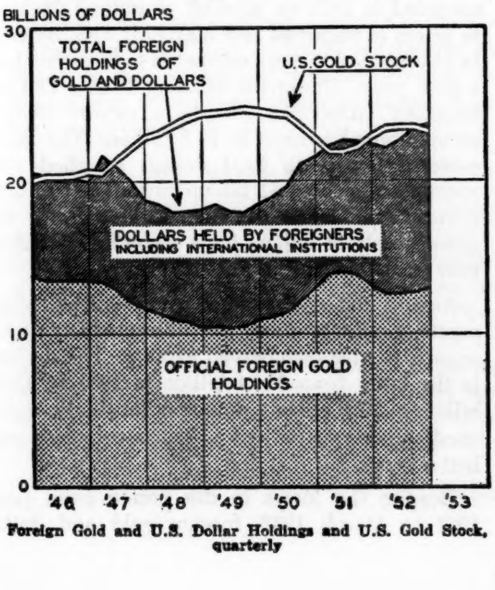
Growth of Foreign Currency Reserves

A $675 million decline in the U.S. gold stock over the past three months signifies a major swing in the U.S. balance of international payments and a switch from dollar shortage to dollar surpluses. The new turn is a timely one. A growing impatience has appeared, abroad as well as at home, with the intergovernmental grant and loan props that have supported a rickety structure of international payments since the war. This feeling is apparent not only among U.S. taxpayers, who feel the main burden, but also among citizens of recipient nations who rebel

at the outside interference with their internal affairs that becomes involved.

Inflationary policies of public finance have played a leading role in the persistence of trade imbalance in the postwar years. As evidenced in the declining price trends of internationally-traded commodities, inflation has now been brought under restraint in most countries. The task of realizing and maintaining reasonable international equilibrium, however, is one that never ends. In the present juncture the gold outflow adds force to the necessity, in the interest of international economic stability, of dealing with our unbalanced federal budget.

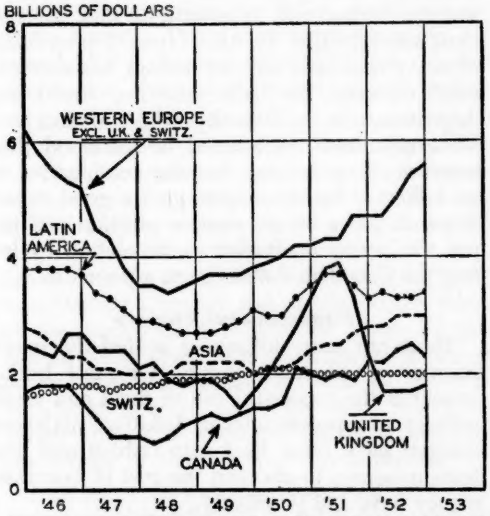
The present swing in the U.S. balance of payments antedates the gold outflow, going back eleven months to last spring. In the last nine months of 1952, through all types of transactions, foreigners are estimated to have added $1½ billion to their gold and dollar reserves. The accumulation was concentrated in dollars up to December when conversions into gold began on a scale of $50 million a week. Rumors of a change in the U.S. price of gold, rampant at that same time, may have given impulse to the movement, though it was almost inevitable that some part of the gains in foreign dollar resources should have been converted into metal. The solid value of gold is appreciated not only by central bankers and finance ministers but also among the broad masses of people who know from bitter experience the capacity of paper money to lose buying power. Gold, when available for sale at a set price, defends the value of paper money. The gold currently being sold by the United States is doing precisely that for the dollar.



Foreign Gold and U.S. Dollar Holdings and U.S. Gold Stock, quarterly

The two charts portray the broad movements in gold and dollar reserves since the war for foreign countries taken as a whole and for individual countries and areas. The first chart shows the U.S. gold stock and total holdings of gold and dollars by foreign nations. Russian gold holdings, an unknown quantity, are excluded. Private holdings, which have been rising since the war, are also omitted for lack of reliable data. Holdings by international institutions, however, are included. The main item here is the $1.7 billion gold hoard of the International Monetary Fund which could be made available to foreign governments or central banks.

The second chart gives gold and dollar holdings for the United Kingdom, Switzerland, other Western Europe, Canada, Latin America, and Asia.



Reported Gold Reserves and U.S. Dollar Balances of Selected Countries and Areas, quarterly

The Postwar Record

As the first chart shows, foreign holdings of gold and dollars were at their lowest point at the time of the widespread currency readjustments in September, 1949. These moves repaired relative overvaluations of most foreign currencies and led to a recovery which was extended and enlarged during the surge of American inflation after the outbreak of the war in Korea in June, 1950. By June, 1951 foreign gold and dollar reserves were up $4¾ billion. During the following nine months, through March, 1952, foreign gold and dollar holdings in the aggregate turned downward. While some countries such as Germany and Japan continued to gain in this period, the United Kingdom was a heavy loser, particularly from the collapse of world prices of wool, tin and rubber. During the winter of 1951-52,

to correct its international position, the United Kingdom and associated sterling area countries tightened import restrictions and the Bank of England raised the discount rate. Such moves, and increased export efforts, turned the British position around during the spring and summer. The United Kingdom added $184 million to its international reserves between March 31 and December 31 after paying $181 million on its American and Canadian postwar loans. Further gains have been realized since December.

Individual countries have their troubles, and it is a rare day when one or another does not. But, with this sort of qualification, the recovery has had a broad basis. In continental Western Europe, while France still suffers balance of payments difficulties, Switzerland has held its outstandingly strong position. Germany, Belgium and the Netherlands have built up their reserves most substantially. In Asia, Japan, a beneficiary of heavy American military outlays, has strengthened reserves. In Latin America, Brazil and Argentina are in difficulty while Mexico and Venezuela have maintained or increased their reserves. Canada, enjoying the combination of an inflow of foreign capital and a good export demand, has a strong reserve position and has put the brakes on further accumulation by letting the Canadian dollar rise to a premium.

Fundamental Factors

There are many influences behind the recent balance of payments swing. Of most lasting benefit is the successful use of fiscal and credit policies to suppress internal inflation. Balanced budgets have come back into fashion and artificial measures to cheapen the cost of borrowed money have lost popularity.

A second factor is the maintenance of tight foreign exchange and trade restrictions, most notable in the case of sterling area countries but by no means confined to them. This is the method of balancing up international accounts by rationing foreign exchange income. It serves in emergency but only by stifling the natural flow of goods, people and money among the nations.

A third influence bringing the new upturn in foreign gold and dollar reserves is the continuance of abnormal U.S. outlays abroad – not only under the Mutual Security Assistance Act and manifold other programs, but also for maintenance of troops and military procurement overseas. These items, along with overseas capital investments, have swollen the flow of dollars abroad to a point where they exceed the amounts foreigners require to pay for goods and services bought here.

The U.S. Balance of Payments

The following table sets out the U.S. balance of payments, annually since 1949, reconciled out to the changes in foreign gold and dollar holdings. The figures for 1952 are partly estimated.

U.S. International Payments

(In Billions of Dollars)

	1949	1950	1951	1952 (est.)
Transactions Supplying Dollars:				
Merchandise imports	$ 7.1	$ 9.3	$11.7	$11.4
Foreign freight and shipping	.7	.8	.9	1.0
Travel by Americans	.7	.7	.7	.8
U.S. Gov. expenditure abroad	.7	.7	1.2	1.6
Private gifts, misc. items	.7	.7	.7	.7
Dividends and interest	.3	.4	.4	.4
Goods and services, total	10.2	12.6	15.6	15.9
Other Dollars Supplied:				
U.S. overseas investments	1.3	1.3	1.1	1.3
Other capital transactions	—.1	—.8	.7	.1
U.S. Gov. economic aid	5.2	3.7	3.0	2.0
Total	6.4	4.2	4.8	3.4
Total Dollars Supplied	16.6	16.8	20.4	19.3
Transactions Using Dollars:				
Merchandise exports	12.3	10.7	15.5	15.5
Less military aid	—	.3	1.1	2.2
Commercial exports	12.3	10.4	14.4	13.3
American freight and shipping	1.2	.9	1.5	1.4
Travel by foreigners	.4	.4	.4	.5
Dividends and interest	1.4	1.7	2.0	1.9
Miscellaneous items	.7	.7	.8	1.0
Goods and services, total	16.0	14.1	19.1	18.1
Surplus on Trade & Service Acct.	5.8	1.5	3.5	2.2
Deficit in International Payments	—.6	—2.7	—1.3	—1.2
Increase (+) or Decrease (—) in:				
Foreign gold and $ balances	—.2	+2.6	+1.0	+1.0
Errors and omissions	+.8	+ .1	+ .3	+ .2
Net	+.6	+2.7	+1.3	+1.2

Based on the Dept. of Commerce data; 1952 partly estimated by this Bank.

The table shows, among the transactions supplying dollars, the post-Korean increase in government expenditures abroad. The main category, merchandise imports, in 1952 was moderately below the record $11.7 billion figure recorded in 1951 as a result of radical declines in prices of imported raw materials. U.S. imports in physical volume are estimated to have reached a new peak. Under the heading "Other Dollars Supplied" American long-term capital investments abroad amount to $1.3 billion. The moderate shrinkage in total dollars supplied was accounted for by a $1 billion curtailment in U.S. government economic aid. Nevertheless, the gross supply of dollars for a second consecutive year exceeded $19 billion.

Among the transactions using dollars, shipments of military goods are subtracted from total exports to give commercial exports. The decline in the latter from $14.4 billion in 1951 to $13.3 billion in 1952 reflects, among other things, tightened import restrictions in some countries and better crops.

Despite the losses in the period from June 1951 to March 1952, foreign gold and dollar

holdings have increased in each calendar year since 1949. In 1949 Marshall Plan aid, running beyond $5 billion, was the balancing factor. As that program ran off according to plan, the unplanned Korean war increased the supplies of dollars and extended the rise in foreign reserves. As the figures are going, on the basis of continuing heavy government outlays abroad, the rise in foreign gold and dollar holdings may be even larger this year than in 1952.

Significance of Reaccumulation

It is encouraging to see an improved distribution of international reserves and reaccumulations that give the nations leeway to meet periods of adversity out of ready resources and without having to face immediate crisis and to ask for new American aid programs.

Gold and dollars, to be sure, are no more than means to ends. One of these is to stabilize foreign currency values and to give a basis of credit and confidence at home and abroad. Another is to give the citizen access to world markets. There is little purpose in excessive accumulations that deny this access. Thus, for nations that have throttled imports to correct adverse trade balances, relaxations of restrictions are in order as reserves build up. Action of this sort not only benefits the citizen at home; it also aids other nations to balance up their international accounts and provide comparative freedom of access to foreign goods. For example, Italy today is hampered by French restrictions affecting Italian goods; France is hampered by British restrictions on French goods. The British complain of the American tariffs.

Though the United States is now the world's biggest importer, and attaches practically no strings on the movements of money abroad, we should have as much readiness as anyone to review trade policies.

U.S. Trade Policy

On the principle of "trade, not aid," many recommendations are being heard in favor of lowering of American tariffs, simplifying customs procedures, eliminating quota restrictions on imports, and repealing legislation of the "Buy American" type. President Eisenhower in his State of the Union address endorsed extension of the Reciprocal Trade Agreements Act and revision of our customs regulations to remove procedural obstacles to profitable trade. Mr. Warren Lee Pierson, chairman of the U.S. Council of the International Chamber of Commerce, has stressed that the escape clause under the Reciprocal Trade Agreements Act, entailing long investigations which can lead to cancellation of tariff concessions, discourages foreign exporters from developing business in this country. "Simplification of our present complicated procedure of getting goods into Customs", he states, "is almost as important as lower tariffs."

American policy for the postwar period has been directed toward easing of barriers on movements of goods, people and capital across national boundaries, to the mutual benefit of the nations and the welfare of their peoples. The defeats of this policy have been more conspicuous than the victories, as witness the morass of restrictions the American exporter encounters abroad. Nevertheless, the end is worth the patience it costs. The American policy, given renewed life by the new Administration, can and should set an example of liberality in trade policy.

Too much, however, should not be expected out of liberalization of American trade policy. As *The Economist* of London pointed out recently, foreign exporters already have the benefit of a reduction of over 60 per cent, since 1937, in the U.S. tariff on dutiable imports. To get a heavy flow of trade, reasonably well balanced international accounts, and stability in the values of the currencies it is essential above all that nations keep their internal financial affairs in order. Professor Lionel Robbins of the University of London made the point effectively earlier this year when he discussed the long persistence of international disequilibrium:

> Trade policy, however enlightened, will not by itself bring equilibrium if finances are out of order. It is true that unilateral easements of obstacles will mitigate the degree of financial adjustment which may be necessary elsewhere; needless to say, a unilateral reduction of tariffs on the part of the U.S. would do much to ease the financial problems of Europe and the Sterling Area. It is true further that multilateral easements . . . will make it easier for financial policies to be effective; a general reduction of obstacles would almost certainly increase the effectiveness of cost reductions or alterations of exchange rates. But, in the last analysis, until financial conditions are under control trade policy is without a foundation.
>
> It is indeed not easy to overstate the central importance of financial policy in this matter of international balance. For dispassionate study of the facts must surely reveal that it is the failure of financial policies which has been responsible for the persistence of our troubles — to be perfectly explicit, that it is the failure of the non-dollar centres to restrain their expansion which is responsible for their failure to get nearer to closing the dollar gap.

ppines

rto Rico

p. of
ama

gapore

uguay

nezuela

though w
a branch
ar, we
u do
re, too!

LIC OF
MA
ma

APORE
pore

UAY
evideo

ZUELA
as

d in U.S.A.